UNITED STATES DISTRICT COURT
For the Northern District of California

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

In re TERAYON COMMUNICATIONS SYSTEMS, INC. SECURITIES LITIGATION

No. C 00-01967 MHP

MEMORANDUM AND ORDER

This Document Relates To:

ALL ACTIONS

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These consolidated securities class actions were brought on behalf of individuals who purchased the publicly traded common stock of Terayon Communications Systems, Inc. between November 15, 1999 and April 11, 2000. The parties came before the court on Defendants' Motion to disqualify Lead Plaintiffs Cardinal Partners and Marshall Payne. Having reviewed the motion and after hearing on the matter, the court has concerns not only about the appropriateness of Cardinal Partners and Marshall Payne as lead plaintiffs but also about the role of lead counsel. For the reasons set forth below, the court issues the following memorandum and order.

BACKGROUND[1]

I. Cardinal's Investment in Terayon

Cardinal Investment Company ("Cardinal") is an investment company located in Dallas Texas. Cardinal was founded and is operated by Edward ("Rusty") Rose, III. Marshall Payne is an employee of Cardinal, as are James Traweek, Jr. and Kent McGaughy. Declaration of Christopher A. Patz ("Patz Decl.") Ex. 11.

In August of 1999 a publication called "Short Alert" identified Terayon as a good candidate

for short selling. Id., Ex. 1 (Alpert Dep. At 20:14-21:9). A "short sale" is a security trading practice "in which a party speculates that a particular stock will go down in price and seeks to profit from that drop." Lapidus v. Hecht, 232 F.3d 679, 680 (9th Cir. 2000)(quotations and citations omitted). The party places an order to sell a security it does not own. The party borrows the security from a broker and covers the short by subsequently purchasing the security and returning the recently purchased security to the broker. If in the interim period the security's price declined, the purchaser makes a profit. If the price of the security increased in the interim, the purchaser takes a loss.

After becoming aware of Terayon stock through the "Short Alert," Cardinal began shorting Terayon's stock in its clients' accounts. Patz Decl. Ex. 3 (Cardinal Dep. At 108:13-110:8). The parties on whose behalf Cardinal shorted the stock were: Cardinal Partners, Marshall Payne and at least five other individuals and entities. During the third quarter of 1999, Rusty Rose also personally accumulated a large short position in Terayon. By March 2000, Rose had a short position in approximately 125,000 shares of Terayon and Cardinal had another 400,000 shares on behalf of its clients. Id. Exs. 11 &12 (Rose Dep. at 121:3-8)(Cardinal Dep. at 108:22-109:2). Marshall Payne's largest short position was roughly 14,000 shares.

In the Spring of 2000 Cardinal also bet that the price of Terayon stock would fall by buying "put options." "A put option is the right to sell a security at a specified price; thus, the value of a put option increases as the price of the underlying security falls." Magma Power Co. v. Dow Chem. Co., 136 F.3d 316, 321 n.2 (2d Cir. 1998).

Instead of declining as Cardinal had bet, Terayon's stock price rose dramatically. When Cardinal first purchased Terayon stock in August 1999 its highest price had been $41 5/8. In March 2000 Terayon's stock hit an all time high price of $277 5/8. By March 2000, Cardinal and Rose were short more than 500,000 shares – equivalent to an $80 million loss for Cardinal and a loss of $25 million for Rose personally.

Defendants assert that to counteract its losses Cardinal devised a "game plan" to drive down the price of Terayon stock and that this "game plan" was implemented during the class period. Cardinal had a thesis that CableLabs would not accept Terayon's S-CDMA technology as a standard

in the industry. See e.g. Patz Dec. Ex. 1. (Alpert Dep. at 120:12-21). Based on this thesis Cardinal claimed that statements Terayon made to the contrary were fraudulent. Cardinal undertook a campaign to inform the market and regulatory agencies about this alleged fraud and about perceived weaknesses in Terayon's business strategy. Cardinal's goal was to have the market lower the value of Terayon stock which would "help [Cardinal's] investment pay off." Patz Dec. Ex. 1 (Alpert Dep. at 125:7-24).

On October 19, 1999, Cardinal sent a copy of its thesis to reporter Brenda Moore at *The Wall Street Journal*. Id. Ex. 1 (Alpert Dep. at 127:1-8); Ex. 8; Ex. 3 (Cardinal Dep. at 135:18-136:10; Ex. 15. Moore did write an article about Terayon which appeared in *The Wall Street Journal* on December 29, 1999, however the price of Terayon stock remained stable in the two week period after the article appeared. In October 1999 Cardinal also began communicating about Terayon to the Milberg Weiss firm, now designated as lead counsel for plaintiffs in this case. Patz Dec. Ex. 12 (Traweek Dep. at 201:1-202:14). Traweek testified that from 1999 to April 2000 he personally contacted the Milberg Weiss firm "on the order of ten times." Id.

During January and February of 2000, Rose and his staff considered "ways in which Cardinal Investment Company could communicate its views about Terayon to the public." Id. Ex. 11 (Rose Dep. at 58:6-25). In this time period, Cardinal employee Kent McGaughy created a document entitled "Game Plan" which document begins by posing the question "What are the key levers we can pull?" Id. Ex. 20. Whether McGaughy created this document of his own accord or at Rose's suggestion is in dispute. Id. Ex. 11 (Rose Dep. at 58:6-25); McGaughy Supp. RT at 31:5-11. Plaintiffs insinuate that McGaughy then did nothing about the "Game Plan," but this assertion is belied by the deposition testimony where it is clear that the substance of the "Game Plan" was discussed with other Cardinal employees. Compare Plaintiffs' Response to Motion at 8:14-17 ("three pages of hand written notes . . . which were not even shown to anyone else hardly qualifies as an elaborate game plan") with Patz Dec. Ex. 1 (Alpert Dep. at 117:6-118:16.)(discussions were had among Cardinal employees about the "Game Plan"). Moreover, Cardinal employees in fact pursued the agenda items listed on the plan.

One of the items on McGaughy's "Game Plan" called for Cardinal to encourage CableLabs to make a statement about Terayon. Cardinal hoped CableLabs would state unequivocally that Terayon's technology would not be part of a DOCSIS standard, thus lowering Terayon's market value. Id. Ex. 8 (McGaughy Dep. at 44:18-45:6). See also Id. Ex. 11 (Rose Dep. 104:14-23)(Rose communicated Cardinal's thesis with the wish that "everyone would divest their holdings in Terayon" and the wish that the "stock price of Terayon would go down.")

It is undisputed that Cardinal employees bombarded CableLabs with calls. See e.g. Id. Ex. 5 (Fellows Dep. 181:20-182:10)(Alpert alone made 50 phone calls to Fellows). It is also undisputed that starting in February 2000, Cardinal began a letter writing campaign regarding Terayon to the Securities and Exchange Commission ("SEC")[2], the National Association of Securities Dealers ("NASD") and the Assistant United States Attorney for the Southern District of New York. Cardinal's opening letter to the SEC was 12 pages long with 56 footnotes and claimed that "TERAYON HAS BLATANTLY LIED ABOUT ITS INDUSTRY IN EVERY SEC DOCUMENT IT HAS FILED SINCE IT WENT PUBLIC IN ORDER TO FALSELY INFLATE MARKET PERCEPTION ABOUT ITS TECHNOLOGY." Patz. Dec. Ex. 36 at 2 (emphasis in the original). Cardinal wrote letters in a similar vein to the SEC on February 23, March 8, March 15, March 20, April 12 and April 25, 2000.

Starting in February 2000 Internet web site postings encouraged parties to contact the Milberg Weiss firm about a proposed lawsuit against Terayon. Despite the fact that these web postings in February 2000 claimed a lawsuit against Terayon was imminent, the stock drop which is the issue of the current lawsuit did not occur until April 12, 2000. See Patz Dec. Ex. 19 (postings of a_r_san of 2/09/00, 3:12 p.m.("Will there be a class action suit? Messrs Lerach, Weiss will be looking into it.") and 2/09/00, 5:42 p.m. ("I am in the process of faxing my TERN stock transactions to [Milberg Weiss] to initiate the class action lawsuit."). The court notes that the class period in the original complaint, i.e. the first day on which plaintiffs claim they were damaged, was February 9, 2000 the same day these Internet postings appeared. Defendants assert that these web postings were part of plaintiffs' alleged scheme to drive the price of the stock down.

In early April 2000 Cardinal Partners purchased April "puts" on Terayon stock. Id. Ex. 3 (Cardinal Dep. At 13:2-22), Ex. 23, Ex. 60. The "puts" expired on April 15, 2000. Thus Cardinal was betting that something would cause a decline in Terayon stock between April 7 and April 15. On April 11, 2000 Cardinal employee Kent McGaughy called into Terayon's quarterly earnings conference call. McGaughy used a false name, and posing as a *bona fide* securities analyst, accused Terayon of fraud. Defendants assert that two other people participated in the conference call at Cardinal's behest. These two, Jonathan Daws and Amir Elgindy also used false names and raised issues of alleged fraud by Terayon.

On April 12, 2000, Terayon's stock price fell. April 12, 2000 also constituted one of the ten worst declines in NASDAQ history. Plaintiffs filed their complaint in the Central District of California on April 13, 2000 -- clearly indicating that plaintiffs had been in contact with counsel for some time prior to the April 12, 2000 stock decline. While the complaint purports to have been signed on April 12, 2000, the attached "Certification of Named Plaintiff"signed by named plaintiff in that case, Shlomo Birnbaum, was dated April 11, 2000 -- one day prior to Terayon's stock plunge. While neither Cardinal Partners or Payne were named as plaintiffs in the Birnbaum complaint, much of the language of the complaint very closely tracks the language of Cardinal's letters to the SEC. Cardinal Partners and Payne signed their Certification of Named Plaintiffs on April 14, 2000.

Milberg Weiss's relationship with Rose was not limited to the Terayon case. As set out in the Fields v. Biomatrix case, 198 F.R.D. 451, 454 (D.N.J. 2000) the Milberg Weiss firm also represented Rose in an almost identical short sale stock case. As in the case at bar, defendants in Fields also asserted that Rose and his associates had "systematically [made] false and misleading allegations against Biomatrix on Internet message boards" and again as here, the messages advised investors that the writer was planning a securities fraud action and that interested parties should contact the Milberg Weiss firm.

The complaint in the Fields case also was "almost entirely copied from letters written to members of Genzyme's board of directors and to the SEC by short seller, Edward W. "Rusty" Rose, III, and his associates" who had been trying unsuccessfully for months to get Genzyme's board to

cancel the merger in order to cause a decline in Biomatrix stock prices. Fields, 198 F.R.D. at 455.

II. Prior Class Certification Procedures

The original action filed in the Central District of California (Birnbaum) and those filed here in the Northern District (Henry and Pludo) listed the class period as February 2, 2000 to April 11, 2000 inclusive. See Patz Dec., Exs 24, 47. On April 14, 2000, Cardinal Partners and Payne each prepared a "Certification of Named Plaintiff Pursuant to Federal Securities Laws." Patz. Dec., Exs. 24, 27. Pursuant to 15 U.S.C. 78u-4(a)(2)(A)(iv), the proposed named plaintiffs are to state on the certification "all of the transactions of the plaintiff in the security that is the subject of the complaint *during the class period specified by the complaint*." Id. (emphasis added). The Certifications filed by Cardinal Partners and Payne were deficient on their face as they did not reveal Cardinal Partners "put" transactions made in early April. Because Cardinal and Payne's numerous short sales all occurred outside this February-April window, counsel and plaintiffs were not at that time required by the statute to list the short sales on the certification. Nonetheless, given the magnitude of the short sales, and that the losses incurred during the class period were as a result of the short sales prior to the class period, these transactions were highly relevant to the case. The court assumes that plaintiffs' counsel was aware of these short sales when it drafted the original complaint with the February to April class period.

On June 12, 2000 plaintiffs filed a motion in the Pludo action to appoint Cardinal Partners, Marshall Payne and three other individuals as lead plaintiffs. This motion states that Marshall and Payne had suffered losses of almost $2.5 million during the February to April class period, but omitted the fact that these losses resulted from Cardinal Partners and Payne's significant short position in Terayon. Counsel for Cardinal and Payne also indicated that "there is no evidence of any antagonism between interests of these individuals and the proposed class members." Terayon Lead Plaintiffs' Group Motion at 13:4-5. Counsel made no mention to the court either in papers or at the hearing that lead plaintiffs had significant short sales in Terayon stock. See Motion Transcript of 8/7/00 in Henry v. Terayon. On September 19, 2000 this court appointed Cardinal Partners, Payne

and the three other individuals as lead plaintiffs and approved the plaintiffs' selection of counsel Milberg Weiss as lead counsel.

Two days after the court ruled on the lead plaintiff issue, the Milberg Weiss firm filed the consolidated class complaint. The consolidated complaint changed the class period to November 15, 1999 to April 11, 2000. While the new class period clearly encompassed lead plaintiffs' vast short sales, plaintiffs' counsel did not provide the court with updated Certifications of Named Plaintiffs which corresponded to the new class period, nor did counsel apprise the court of the short sales which now clearly came within the class period. The court is left to wonder whether once the court's scrutiny of lead plaintiffs had concluded, counsel felt free to manipulate the class period.

On July 25, 2002 plaintiffs filed their motion for class certification. Plaintiffs' counsel did not propose that lead plaintiffs Cardinal Partners or Marshall Payne be certified as class representatives. It is clear from the deposition testimony that counsel for plaintiffs made the determination not to request class representative status for either Cardinal Partners or Marshall Payne. At the hearing on the present motion, counsel for plaintiffs explained this choice in the following way: "It's unfair to have the class – not saddled with – but be responsible for what Cardinal Partners did or didn't do since they – there's no question – they did a lot of due diligence in investigating this company." September 8, 2003 Hearing Transcript at 18:15-19.

LEGAL STANDARD

A. Appointment as a Lead Plaintiff

The Private Securities Litigation Reform Act ("PSLRA") sets forth a rebuttable presumption that the "most adequate plaintiff," i.e., the one who is to be selected as lead plaintiff, is the one who:

> (aa) has either filed the complaint or made a motion in response to a notice under subparagraph (A)(I);
> (bb) in the determination of the court, has the largest financial interest in the relief sought by the class; and
> (cc) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.

15 U.S.C. § 78u-4(a)(3)(B)(iii)(I).

This presumption may be rebutted only upon proof *by a member of the purported plaintiff class* that the presumptively most adequate plaintiff (a) will not fairly and adequately protect the interests of the class; or (b) is subject to unique defenses that render such plaintiff incapable of inadequately representing the class. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(II) (emphasis added).

In order to be appointed a lead plaintiff the prospective lead plaintiff must satisfy the requirements of typicality and adequacy set forth in Rule 23 of the Federal Rules of Civil Procedure. Federal Rule of Civil Procedure 23(a)(4) provides that the representative parties must "fairly and adequately protect the interests of the class." Fed. R. Civ. P. 23(a)(4). Generally, plaintiffs bear the burden of showing that their claims are typical, as well as the burden of demonstrating that other prerequisites to class action are satisfied. Fed.R.Civ.P. Rule 23(a); see Staton v. Boeing 2002 WL 31656586 (9th Cir. 2002); see also In re Dalkon Shield IUD Products Liability Litigation, 693 F.2d 847 (9th Cir. 1982)

DISCUSSION

Defendants present several arguments as to why plaintiffs Cardinal Partners and Marshall Payne should no longer be designated as lead plaintiffs. Defendants assert that Cardinal and Payne should not be lead plaintiffs as they were short-sellers. Defendants contend that neither Cardinal Partners nor Marshall Payne relied on Terayon's representations and thus cannot represent other plaintiffs in a fraud on the market case. Finally defendants assert that these two plaintiffs have a conflict of interest with the plaintiffs' class and cannot act as fiduciaries as required by Federal Rule of Civil Procedure 23.

Plaintiffs argue that defendants have no standing to challenge the appointment of lead plaintiffs and that even if they did, there is no reason that short sellers cannot be lead plaintiffs.

A. Standing to Challenge the Appointment of Lead Plaintiffs

Lead plaintiffs have a fiduciary duty to "monitor, manage and control the litigation, making,

as is the case in ordinary cases, litigation decisions on resource allocation and settlement with, of course, the advice of, but not the prerogative of class counsel." In re Network Assocs., Inc. Sec. Litig., 76 F.Supp.2d 1017, 1020 (N.D. Cal. 1999). As noted above, the PSLRA provides that the presumption of adequacy of a lead plaintiff "may be rebutted only upon proof by a member of the purported plaintiff class." 15 U.S.C. § 78u-4(a)(3)(B)(iii)(II). Plaintiffs read this section to act as an absolute bar to a motion brought by the defendants or for that matter presumably to the court acting *sua sponte* based on information made available to it. In support of their proposition, plaintiffs cite to Wenderhold v. Cylink Corp., 188 F.R.D. 577 (N.D. Cal 1999). The Wenderhold case is inapposite as the court specifically did not reach the issue of defendants' standing. The Wenderhold court did, however, reiterate a court's ongoing obligation to determine the appropriateness of the lead plaintiffs. Wenderhold, 188 F.R.D. at 584. (regardless of whether defendants have standing to object, the court is required to determine whether the proposed lead plaintiffs are capable of adequately protecting the interests of the class members).

Nor does Takeda v. Turbodyne, 67 F.Supp.2d 1129 (C.D. Cal 1999) aid plaintiffs' argument. Although the court in Takeda found that defendants lacked standing at the early stages of the proceeding it did not rule out the possibility that defendants would later have standing to make such a challenge. More importantly, Takeda held that the court could "raise and address certain of the concerns addressed in defendants' statement" *sua sponte.* Takeda, 67 F.Supp. 2d 1138. See also Fields v. Biomatrix, 198 F.R.D. 451, 454 (D.N.J. 2000).

In re Cavanaugh, the only Ninth Circuit law plaintiffs cite, is inapposite due to the procedural posture of the case at bar. In re Cavanaugh, 306 F3d 726 (9th Cir. 2002). In Cavanaugh, the Ninth Circuit reviewed on a writ the district court's use of an interview process to select the lead plaintiff. The Ninth Circuit rejected this process, referring the court back to the lead plaintiff selection scheme elaborated under the PSLRA. No defendant in Cavanaugh sought to have input into the lead plaintiff decision, so the case is not dispositive. Nor had discovery already been taken. In the case at bar, extensive discovery has been taken and the case is on the brink of trial. Therefore, the court does not find Cavanaugh persuasive.

What is clear under the reasoning of Wenderhold and Takeda, is that the court has a duty to monitor whether lead plaintiffs are capable of adequately protecting the interests of the class members. As the court held in In re Critical Path, "the fact that a searching inquiry under Rule 23 is not required at this stage of the litigation does not mean that the Court must pay mere lip service to the requirement of the statute that a prospective lead plaintiff 'satisf[y] the requirements of Rule 23.'" In re Critical Path, Inc. Sec. Litig., 156 F.Supp.2d 1102 (N.D. Cal. 2001). *See* 15 U.S.C. § 78u-4(a)(3)(b)(iii)(I)(cc). The doctrine against conducting a searching inquiry under Rule 23 at the earliest stage of the lawsuit encourages efficiency. However, the court has a continuing responsibility to determine whether lead plaintiffs meet the typicality and adequacy prongs of Rule 23 such that the interests of the class are protected. See.e.g. Z-Seven Fund, Inc. v. Motorcar Parts & Accessories, 231 F.3d 1215, 1218-19(9th Cir. 2000)(district court may make changes to lead plaintiff status consistent with court's continuing duty to ensure adequate representation of class.).

Normally, these issues would have been raised at the time the lead plaintiffs moved to be appointed as class representatives. Plaintiffs' counsel circumvented this inquiry by determining to only seek class representative status for the three individual defendants and not for Cardinal Partners and Payne. But for the machinations of plaintiffs' counsel, the defendants likely would have been able to present evidence regarding the fitness of Cardinal and Payne as lead plaintiffs at an earlier stage in the litigation. Based on the above, the court finds that it has an obligation to consider the material presented by defendant as to Cardinal and Payne's fitness to continue as lead

B. Lead Plaintiffas Short Sellers

Defendants advance several arguments as to why plaintiffs should be disqualified as lead plaintiffs due to their short sale purchases of Terayon stock. Defendants first assert that being a short sale purchaser is *per se* disqualifying for a lead plaintiff. Defendants further argue that Cardinal and Payne cannot be adequate lead plaintiffs in this case since the case is premised on a fraud on the market theory and those two plaintiffs cannot demonstrate reliance on the alleged misrepresentations made by Terayon. In a similar vein, defendants argue that Cardinal and Payne have a fatal conflict of interest with the rest of the plaintiff class. Plaintiffs generally allege damages based on the

devaluation of Terayon stock, whereas Cardinal and Payne actively sought to drive down the price of Terayon stock.

Citing In re Critical Path, defendants assert that short sellers cannot be named as lead plaintiffs.[3] In Critical Path, Columbus Capital, one of the proposed lead plaintiffs, had purchased 410,000 shares and sold 20,000 shares short. Based on these short sales, the court found Columbus Capital not a suitable lead plaintiff. The court held that it would be "a poor choice to appoint a class representative who engaged in a trading practice premised on the belief the stock would fall." Critical Path, 156 F.Supp.2d at 1110. The court analyzed that an issue arises with short sellers as to whether the seller was actually relying on the market price, and that "the court is not served by its representative coming under such scrutiny." Id. See also Weisz v. Calpine Corp., No. C 02-1200 SBA, slip op. at 12 (N.D. Cal. Aug. 19, 2002). Apparently, the desire to avoid such scrutiny was also the motivating factor in plaintiffs' decision not to seek class representative status for Cardinal and Payne. Moreover, unlike in Critical Path, where the lead plaintiff had both short and long purchases, according to deposition testimony, Cardinal Partners never intended at any point to take a long position in Terayon. Patz Dec. Ex. 1 (Alpert Depo. 22:4-10).

Plaintiffs cite no controlling precedent on this issue. Moreover, the court finds the cases plaintiffs rely on to be either inapposite or unpersuasive. The holding of Danis v. USN Communications, 189 F.R.D. 391 (N.D. Ill. 1999) was rejected by the Northern District Court in Critical Path and is distinguishable on the facts as well. In Danis, the court recognized the inherent potential for conflict in a fraud on the market case between lead plaintiff Thomas Karr, who had engaged in short sales, and other plaintiffs who had not: "[t]he motivations behind short selling may indeed be inconsistent with the assumptions underlying the fraud on the market theory." Danis, 189 F.R.D. at 396. Although the court ultimately approved Karr, it did so because Karr had made both short sales and ordinary stock purchases during the class period. The Danis court found that Karr could use "these [ordinary] purchases to invoke the fraud on the market presumption of reliance." Id. Unlike Karr, neither Cardinal nor Payne made ordinary purchases other than those needed to cover their short sales.

The court finds plaintiffs' citation to Fields v. Biomatrix, 198 F.R.D. 451, 454 (D.N.J. 2000) illuminating not for its reasoning or holding but for the facts of the case which tend to support defendants claims about Cardinal and Payne. If the court had reservations about the "typicality" of short sellers Cardinal and Payne before, the Fields case provides the response. While some short sales may not, in and of themselves render a lead plaintiff's claims atypical, a pattern of affirmatively engaging in campaigns devised to lower the price of the stock in question certainly contains within it the seeds of discord between lead plaintiffs and the remaining plaintiffs.[4] Based upon the exposition herein, to the extent that Cardinal and Payne appear as lead plaintiffs or class representatives, the court removes them from those respective positions.

C. Concerns about Lead Counsel

The court is extremely concerned by the lack of candor to the court by plaintiffs and by lead counsel. As in the Fields case, evidence in the record indicates that counsel had been working with plaintiffs Cardinal and Payne significantly in advance of the filing of the complaint. In October 1999 Cardinal began passing information about Terayon to the Milberg Weiss firm. Patz Dec. Ex. 12 (Traweek Dep. at 201:1-202:9).

In both the Fields case and the case at bar, posting on Internet web sites encouraged parties to contact the Milberg Weiss firm not only before the complaint was filed, but at least in the Terayon case at least two months before there was even a drop in the stock price. Despite the fact that these web postings in February 2000 claimed a lawsuit against Terayon was imminent, the stock drop which is the issue of the current lawsuit did not occur until April 12, 2000. Questions arise as to what knowledge of, or participation in, this plan the Milberg Weiss firm may have had.

Plaintiffs filed their complaint on April 13, 2000. While the Birnbaum complaint purports to have been signed on April 12, 2000, the attached "Certification of Named Plaintiff" was dated April 11, 2000 -- one day prior to Terayon's stock plunge. This fact again raises issues about knowledge by counsel of plaintiffs' actions during the Terayon conference call, which actions were allegedly intended to devalue Terayon stock.

The court is of the impression that the Milberg Weiss firm was in close contact with plaintiff Cardinal significantly in advance of the time the suit was filed as much of the language of the complaint tracks the language of Cardinal's letters to the SEC. The court is also greatly troubled by an apparent attempt to mislead the court as to the scope and nature of lead plaintiffs' holdings in Terayon stock. As noted above, the Certifications filed by Cardinal Partners and Payne did not reveal Cardinal Partners "put" transactions, nor did they reveal Cardinal Partners and Payne's short sales in Terayon stock. That counsel made a change to the class period only two days after this court approved lead plaintiffs, coupled with the fact that counsel made no effort to update the certifications so that they would accord to the requirements of 15 U.S.C. 78u-4(a)(2)(A)(iv), gives rise to the presumption that these actions were taken intentionally to avoid closer court scrutiny of plaintiffs Cardinal Partners and Payne. Counsel's later decision not to request class representative status for either Cardinal Partners or Marshall Payne is similarly suspect. All of these issues leave the court to speculate whether counsel for plaintiffs actively participated in or provided advice to plaintiffs regarding their scheme to cause a fall in Terayon's stock price.[5] In either case, the court finds that it is probable that there is a conflict not only between lead plaintiffs and the class but also between lead counsel and the remainder of the class.

CONCLUSION

As detailed above, the court finds that according to information currently available to it, lead plaintiffs do not meet the typicality and adequacy of representation requirements of Rule 23 and this are not appropriate lead plaintiffs.

As it relates to class counsel, the court has serious concerns about potential conflicts of interest and also counsel's candor to the court. As the court indicated at the hearing, the court wishes further discovery into at a minimum, the following issues:

(1) The number of cases or actions in which Milberg Weiss represents Rose, Payne, Cardinal Partners any other Cardinal entity or affiliate;

(2) The dates that Milberg Weiss was first contacted by each of those parties and the date

Milberg Weiss was retained as counsel by each of those parties;

(3) The amount of fees billed to those entities and paid by them and the dates of such billings and payments;

(4) The fee arrangements that existed between those parties and the Milberg Weiss firm since the beginning of any representation by Milberg Weiss of any of these parties through and including the present.

(5) The names of all attorneys at the Milberg Weiss firm who have worked for any of these clients, the dates they provided such services, and if the work was related to a filed action, to which action was it related.

Counsel for defendants may also propound any relevant discovery seeking non-privileged information by_____.[6]

The Milberg Weiss firm shall have thirty (30) days from service this order to file the information ordered by this court.

The Milberg Weiss firm shall have thirty (30) days from the service of the discovery requests to respond to the discovery propounded by defendants on these issues, with copies to defense counsel and the court.

IT IS SO ORDERED.

Dated: _____

Marilyn Hall Patel
Chief Judge
United States District Court
Northern District of California

UNITED STATES DISTRICT COURT
For the Northern District of California

ENDNOTES

1. The court assumes familiarity with background facts of the case as set out in detail in the court's prior orders.

2. Cardinal sent letters to several individuals at the SEC including Brian J. Lane, Director of Corporate Finance, Bud Ross at the Office of Internet Enforcement and Barry Summers, Associate Director of the Financial Services Division of Corporate Finance.

3. Further, if plaintiffs had disclosed to the court that they were short sellers at the time they filled out the request for appointment, defendants believe that this court never would have named them as lead plaintiffs in the first place.

4. Indeed, Cardinal and Payne appear to have participated, if not perpetrated, a fraud of their own on the market. Other class members who were not parties to or aware of their scheme may find they have a claim against their purported class representatives.

5. Milberg Weiss bills itself as "the recognized leader in the fight against securities fraud....known for its fierce representation of aggrieved shareholders." www.milberg.com. It may be that the ferocity has crossed the line, for certainly looking at the actions of their clients Cardinal and Payne the court wonders which of them was the aggrieved shareholder.

6. The court is willing to entertain a motion addressing whether the privilege has been waived to any extent, and, if so, to what extent.